

STATE OF NEW YORK
DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
NET REALTY HOLDING TRUST	:	ORDER
	:	DTA NO. 812217
for Revision of a Determination or for Refund	:	
of Real Estate Transfer Tax under Article 31	:	
of the Tax Law.	:	

Petitioner, Net Realty Holding Trust, 535 Boylston Street, Boston, Massachusetts 02116, filed a petition for revision of a determination or for refund of real estate transfer tax under Article 31 of the Tax Law.

Petitioner brought a motion for summary determination pursuant to section 3000.5(c) of the Rules of Practice and Procedure of the Tax Appeals Tribunal. The motion is dated February 4, 1994 and has a return date of March 10, 1994. Petitioner appeared in support of the motion by Stephan B. Gleich, Esq. The Division of Taxation appeared in opposition to the motion by William F. Collins, Esq. (Andrew J. Zalewski, Esq., of counsel).

Petitioner filed an affirmation in support of the motion, a memorandum of law and supporting documents on February 7, 1994. The Division of Taxation filed an affirmation in opposition to the motion and supporting documents on March 2, 1994. Petitioner filed a reply affirmation and supporting documents on March 10, 1994. Based on all of the pleadings and documents submitted, Jean Corigliano, Administrative Law Judge, renders the following order.

ISSUES

I. Whether the preemption provisions of the Federal Employee Retirement Income Security Act of 1974 preempt the Division of Taxation from subjecting petitioner to the real estate transfer tax.

II. Whether, in a conveyance pursuant to a foreclosure, "consideration", as defined by Tax Law § 1401(d), means the higher of the amount of the foreclosure judgment or the bid price.

FINDINGS OF FACT

The New England Teamsters and Trucking Industry and Pension Fund (the "Pension Fund") was organized pursuant to section 302(c) of the Labor Management Relations Act of 1947, as amended (29 USC 186[c]). The Pension Fund was, at all relevant times, a qualified employee benefit plan under the Federal Employee Retirement Income Security Act of 1974 ("ERISA").

Petitioner, Net Realty Holding Trust ("NET"), is the nominee of, and is wholly-owned by its beneficiary, the Pension Fund. It was organized to hold title to and manage properties on behalf of the Pension Fund.

Letters of determination issued by the Internal Revenue Service establish that as of 1970 NET was determined to be a qualified trust under section 401(a) of the Internal Revenue Code and thus exempt from Federal income taxes under section 501(a) of the Internal Revenue Code.

NET was the second mortgagee on certain real property known as 400 Columbus Avenue, Mt. Pleasant, New York. As of December 13, 1991, the defaulting mortgagor owed NET \$15,818,094.19; and NET brought a motion in Supreme Court, Westchester County, to foreclose the mortgage. A Judgment of Foreclosure and Sale was issued on April 7, 1992 which, among other things, ordered the sale of the subject real property at public auction. The judgment order contained the following relevant provisions:

"[I]t is further

"ORDERED, ADJUDGED AND DECREED that, the Referee make a Report of Sale and file it with the Clerk of the County of Westchester with all convenient speed; the purchaser or purchasers at such sale shall be let into possession upon production of the Referee's deed or deeds; if the proceeds of such sale be insufficient to pay the amount so reported due to the plaintiff with interest, costs and allowances as aforesaid, the Referee shall specify the amount of such deficiency in his Report of Sale; and it is further

"ORDERED, ADJUDGED AND DECREED that, in the event that plaintiff shall become the purchaser of the premises directed to be sold, or that the rights of the purchaser at said sale, and the terms of sale under this judgment shall be assigned to or acquired by the plaintiff and a duly executed assignment in writing be filed with the Referee, the Referee shall not require the plaintiff to pay in cash the entire amount bid at said sale, but shall execute and deliver to the plaintiff a deed or deeds of the premises sold upon payment to the Referee of the amounts specified above in the paragraphs marked 'FIRST', 'SECOND', and 'THIRD', or in

lieu of such payments, upon filing with said Referee receipts of the proper municipal authorities showing such payments. The balance of the amount bid, if any, shall be allowed to the plaintiff, and applied pursuant to paragraph 'FOURTH' above. If thereafter there shall be a surplus over and above the amounts due to the plaintiff, the plaintiff shall pay the same to said Referee upon delivery to it of the Referee's deed, and the Referee shall then deposit such amount with the aforesaid depository"

NET was the highest bidder at the foreclosure sale, purchasing the property for the sum of \$8,000,000.00. Petitioner obtained the subject real property with a pre-existing mortgage of \$1,958,785.00.

On or about June 2, 1992, NET filed a Combined Real Property Transfer Gains Tax Affidavit and Real Estate Transfer Tax Return (Form TP-584), reporting the conveyance of the real property pursuant to the foreclosure sale. Schedule E of Form TP-584 instructs the taxpayer to calculate the consideration by adding "[t]he amount of foreclosure judgment or bid price by grantee whichever is higher" to the amount of any pre-existing mortgage or lien. In accordance with this instruction, NET added the amount of the foreclosure judgment, \$15,818,094.19, to the amount of the pre-existing mortgage remaining on the property, \$1,958,785.00, arriving at a total of \$17,776,879.19. It paid real estate transfer tax on the conveyance of \$71,108.00.

NET filed a claim for refund of tax dated March 22, 1993, advancing two arguments to support its claim for refund. First, it claimed that as an ERISA trust it was exempt from payment of the real estate transfer tax. Second, it took the position that if any tax must be paid, the tax should be imposed on the total of the bid price (\$8,000,000.00) plus the amount of the first mortgage, a total of \$9,958,785.00.

The Division of Taxation ("Division") denied NET's claim for refund in a letter dated June 9, 1993, giving the following explanation for its determination:

"There is no provision stated under Article 31, New York State Real Estate Transfer Tax Law for the exemption of the payment of tax by an Erisa trust.

"In addition, if real property is being conveyed pursuant to a mortgage foreclosure, the consideration is the amount of judgement in foreclosure or the bid price, which ever is higher, plus the amount of any other pre-existing mortgages, liens or other encumbrances remaining on the property after the transfer."

NET filed a petition protesting the denial of its refund claim on September 2, 1993.

In its petition, NET stated:

"If NET must pay any transfer tax, it should pay a transfer tax on \$9,958,785.00, the total of the bid price (\$8,000,000.00) which reflected the fair market value of the property at the time of the sale, plus the first mortgage (\$1,958,785.00). NET is, therefore, entitled to a refund of \$31,273.00 (\$71,108.00 less \$39,835.00)." (Emphasis added.)

The Division filed an answer on or about October 19, 1993, denying the above statement (among others), and stating that the consideration paid for the subject property properly included the entire amount of the foreclosure judgment.

The Division submitted the following documents as exhibits: NET's petition with attachments, including a copy of the Division's letter denying NET's refund claim; a copy of the Form TP-584 filed by petitioner; a copy of NET's refund claim; and a copy of the Division's answer. The Division offered no evidence of its own to controvert the factual claims made by NET's attorney in an affirmation.¹ However, in his affirmation, the Division's attorney states:

"[P]etitioner alleges numerous times that the petitioner 'obtained property less than the judgment amount' and obtained such property for a bid price that, 'reflected the fair market value of the property at the time of the sale.' These factual allegations are material elements to the arguments the petitioner makes with respect to its claim for a partial refund of the real estate transfer tax imposed by Article 31 of the Tax Law. The taxpayer's failure to offer any evidence with respect to these issues requires the dismissal of the instant motion."

In response to the Division's statements, NET filed: a reply affirmation; a copy of a deed which established that NET acquired the subject property at a bid price of \$8,000,000.00; and two appraisal letters. The first appraisal letter establishes that as of November 13, 1991 the property was appraised at a value of \$8,500,000.00. A second appraisal letter establishes that as of July 15, 1993 the subject property was appraised at a value of \$3,500,000.00.

CONCLUSIONS OF LAW

A. In this proceeding, NET claims that there are no factual issues in dispute and that

¹Mr. Gleich acted as NET's attorney in the foreclosure proceeding and, therefore, had personal knowledge of the facts stated in his affirmation.

resolution of the issues raised in its petition revolves

only around issues of law. It repeats the arguments made in its claim for refund stating that it is entitled to a complete refund of the tax paid because it is exempt from payment of the real estate transfer tax as an ERISA trust. In the alternative, NET argues that it is entitled to a partial refund of \$31,273.00. The Division takes the position that as to each of the issues raised by petitioner there are material issues of fact requiring a hearing and denial of petitioner's motion. In addition, the Division takes the position that the real property transfer tax is a "cost of doing business" and as such is distinguishable from the real property gains tax which the Court of Appeals has held to be covered by the broad preemption provisions of ERISA. The Division did not address NET's alternative legal argument regarding the interpretation of the term "consideration" as it is used in article 31 of the Tax Law.

B. Before considering whether the provisions of the real property tax law are preempted by ERISA, I will first address the Division's assertion that as to this issue there are material and triable issues of fact requiring a hearing. In Matter of Morgan Guar. Trust Co. v. Tax Appeals Tribunal (80 NY2d 44, 587 NYS2d 252), the Court of Appeals held that the real property gains tax law of article 31-B is preempted by certain provisions of ERISA.² As the Division notes, the Court reached this

conclusion "from an analysis of the structural, administrative and economic impact of the tax on the Plan" (Matter of Morgan Guar. Trust Co. v. Tax Appeals Tribunal, supra, 587 NYS2d at

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"ERISA is a comprehensive statute enacted to promote and protect the interests of participants and their beneficiaries in employee benefit plans by subjecting the plans to uniform federal regulation. It establishes certain substantive requirements concerning participation, funding and vesting of pension plans and also imposes various procedural standards regarding disclosure, reporting and fiduciary responsibility" (Matter of Morgan Guar. Trust Co., Tax Appeals Tribunal, May 10, 1990; citations omitted).

256). However, I cannot agree with the Division that:

"there are material factual issues concerning how the Real Estate Transfer Tax impacts upon the structure and administration of the New England Teamsters and Trucking Industry Pension Plan" (Affirmation of Andrew J. Zalewski, ¶ 10).

In support of its motion for summary determination, petitioner submitted a copy of the New England Teamsters and Trucking Industry Pension Plan 1985 (the "Plan"), which describes the structure and administration of the Plan. It also submitted the Nominee Agreement by which the Pension Fund appointed NET as trustee. Moreover, as an ERISA qualified trust, the Plan's structure and administration are subject to the requirements of ERISA. The Division has not addressed the sufficiency of this proof much less "shown facts sufficient to require a hearing of any issue of fact" (20 NYCRR 3000.5[c][1]). A motion for summary determination cannot be defeated by the bare allegation that issues of fact exist with no specific factual references (see, Zuckerman v. City of New York, 49 NY2d 557, 427 NYS2d 595; Shaw v. Time-Life Records, 38, NY2d 201, 379 NYS2d 390; Indig v. Finkelstein, 23 NY2d 728, 296 NYS2d 370). In this instance, however, the Division's failure to produce evidence sufficient to create a genuine issue of fact does not dictate a determination in petitioner's favor, since petitioner has not shown that it is entitled to summary determination in its favor as a matter of law (see, Matter of Walski v. Forma, 54 AD2d 767, 387 NYS2d 538).

C. Analysis of petitioner's preemption argument will begin with a summary of the ERISA preemption principles as outlined by the Court of Appeals in Matter of Morgan Guar. Trust v. Tax Appeals Tribunal (*supra*). The preemption provisions of ERISA reflect a broad preemption policy. 29 USC § 1144(a) states that:

"the provisions [of ERISA] shall supersede any and all State laws insofar as they may now or hereafter relate to any [covered] employee benefit plan."

While explicitly exempting State laws of general application (insurance, banking or securities, as well as State criminal statutes), ERISA made no mention of tax law in the original preemption provision (see, 29 USC § 1144[b][2][A]; [4]). In 1983, Congress amended the statute to affirm more specifically that "any State tax law relating to employee benefit plans" is preempted by ERISA (29 USC § 1144[b][5][B][i]). ERISA preempts not only laws specifically

designed to affect employee benefit plans, but also laws of general application if they "relate to" employee benefit plans (Mackey v. Lanier Collection Agency & Serv., 486 US 825, 100 L Ed 2d 836).

Petitioner's argument that the real estate transfer tax relates to the Plan in more than a tenuous, peripheral or remote manner can be reduced to one simple proposition: since the tax must be paid from Plan income, the amounts available for distribution to Plan beneficiaries will be reduced. I conclude that this is not a direct enough relationship to trigger preemption under ERISA. This conclusion is based upon a reading of the Court of Appeals's decision in Matter of Morgan Guar. Trust v. Tax Appeals Tribunal, *supra*).

The conclusion in Morgan Guaranty that "[the] gains tax has more than a tenuous, remote or peripheral connection to employee benefit plans and is therefore preempted by ERISA" (Matter of Morgan Guar. Trust v. Tax Appeals Tribunal, *supra*, 587 NYS2d at 256) was based on three factors. The court found that the administrative and recordkeeping requirements of the gains tax law (Tax Law §§ 1447[2]; 1448[2], [3]) "would impose certain recordkeeping and reporting requirements on the Plan, mandating administrative procedures pertaining to asset disposition not required in other jurisdictions" (Matter of Morgan Guar. Trust v. Tax Appeals Tribunal, *supra*, 587 NYS2d at 256). Second, the court found that subjecting employee benefit plans to the gains tax would influence a plan's investment strategy. The court noted that New York fiduciaries would have to consider the State law that, by directly taxing gains on the sale of certain real property, would make such assets less attractive investments. For the same reasons, a New York fiduciary might be required to retain an asset that would otherwise have been liquidated. Thus, the court found that the gains tax would have the effect of causing employers to tailor their conduct "to the peculiarities of the law of each jurisdiction" (Ingersoll-Rand Co. v. McClendon, 498 US 133, 142, 112 L Ed 2d 474, 484, quoted in Matter of Morgan Guar. Trust v. Tax Appeals Tribunal, *supra*, 587 NYS2d at 256). Finally, the court found that preemption of the gains tax law would be consistent with the favorable treatment afforded benefit plans under the Internal Revenue Code which exempts earnings on a plan's assets from

Federal taxation (see, 26 USC § 501[a]). (Matter of Morgan Guar. Trust v. Tax Appeals Tribunal, supra, 587 NYS2d at 256.)

Application of the factors considered significant by the court in Morgan Guaranty yields a very different result when applied to the real estate transfer tax. Tax Law § 1402 imposes a tax "on each conveyance of real property or interest therein when the consideration exceeds five hundred dollars, at the rate of two dollars for each five hundred dollars or fractional part thereof." Article 31 imposes no recordkeeping or filing requirements similar to those found in the gains tax law, and, as a consequence, the real estate transfer tax does not mandate administrative procedures which are not imposed by other jurisdictions. In addition, it is not apparent that the real estate transfer tax (which imposes a tax of less than 1%) would have a significant influence on the Pension Fund's investment strategy. As noted by the dissenting member of the Tax Appeals Tribunal:

"the gains tax . . . is applied directly to an intrinsic part of the plan, i.e., to the earnings derived from the sale of a Plan asset by the Plan itself" (Matter of Morgan Guar. Trust, Tax Appeals Tribunal, May 10, 1990; emphasis in original).

The real estate transfer tax is not applied to earnings. Rather, it is a tax imposed "on each deed at the time it is delivered by a grantor to a grantee" (20 NYCRR 575.1). Since there is no direct relationship between earnings derived from the real estate conveyed by the deed and the amount of the tax, the transfer tax cannot have a direct influence on the investment strategies of pension plan fiduciaries in the same way that the gains tax might. Finally, the real estate transfer tax has no counterpart in the Internal Revenue Code; therefore, a direct relationship cannot be drawn between the Federal policy of exempting pension plan income from Federal tax and the State's imposition of a tax on the conveyance of a deed.

The real estate transfer tax is a stamp or excise tax and as such is unlike the gains tax (see, 995 Fifth Ave. Assocs. v. New York State Dept. of Taxation & Fin., 963 F2d 503). In fact, the real estate transfer tax is more like the sales tax in that both are transaction taxes and, as such, a cost of doing business in New York. In support of its position, the Division states that:

"it important [sic] to consider the Court of Appeals effort in Morgan to distinguish the gains tax from stamp or documentary transfer taxes."

It also cites to Matter of the American Federation of Musicians' and Employees' Pension Fund v. Tax Commission of the City of N.Y. (NYLJ, March 10, 1993, at 21, col 5). In that case, the court held that New York City's real property tax assessment against an ERISA qualified trust was not preempted by ERISA. Petitioner correctly points out that American Federation has no precedential value, since the court was considering the effect of a different tax from the one levied in the instant case. However, the reasoning of the Supreme Court opinion is persuasive. The opinion rested, in part, on the following passage in Morgan Guaranty:

"As one court has noted, the gains tax is not like a stamp or documentary transfer tax -- taxes generally imposed on the entire consideration paid, at a rate of less than 1%, irrespective of profit (995 Fifth Ave. Assocs. v. New York State Dept. of Taxation & Fin., 963 F2d 503 [2d Cir., 1992]). Instead, this gains tax is contingent on the profitability of the underlying transaction: a 10% tax is imposed directly on the gain -- as defined by the provisions of the gains tax -- accruing to the transferor (id.; compare, Tax Law §§ 1402, 1402-a [real estate transfer tax]). Thus the gains tax is not, as appellants argue, 'akin to a sales tax,' and as such a 'cost of doing business in New York.' It is a direct tax on Plan profits." (Matter of Morgan Guar. Trust v. Tax Appeals Tribunal, supra, 587 NYS2d at 257; emphasis added.)

As this passage demonstrates, the Court of Appeals did not hold that a "cost of doing business tax" is not preempted by ERISA. It merely concluded that the gains tax is not a "cost of doing business tax". However, the court's frequent reference to the fact that the gains tax is a direct tax on profits from plan assets and its careful analysis of the influence of the gains tax on the administration and structure of the plan establish that not all State taxes are preempted by ERISA. In addition, the real estate transfer tax is exactly the type of tax which the Court of Appeals was so careful to distinguish from the gains tax in Morgan Guaranty. The real estate transfer tax impacts on the Plan in only one way -- the tax must be paid from Plan income. This is not sufficient to show that the real estate transfer tax relates to the Plan in more than a tenuous or remote manner. Accordingly, I conclude that the real estate transfer tax is not preempted by ERISA.

Section 3000.5(c) of the Rules of Practice and Procedure of the Tax Appeals Procedure states:

"Where it appears that a party, other than the moving party, is entitled to a summary determination, the administrative law judge may grant such determination without the necessity of a cross-motion."

As there are no material issues of fact requiring a hearing, summary determination is granted to the Division on the issue of preemption.

D. The next issue to be addressed is whether petitioner is entitled to a partial refund of the tax paid.

As petitioner notes, the conveyance of real property by a mortgage foreclosure is subject to the tax imposed under Tax Law § 1402 (see, 20 NYCRR 575.1[e][1]). The real estate transfer tax is imposed on the consideration which is defined in Tax Law § 1401(d), in pertinent part, as follows:

"'Consideration' means the price actually paid or required to be paid for the real property or interest therein, including payment for an option or contract to purchase real property, whether or not expressed in the deed and whether paid or required to be paid by money, property, or any other thing of value. It shall include the cancellation or discharge of an indebtedness or obligation. It shall also include the amount of any mortgage, purchase money mortgage, lien or other encumbrance, whether or not the underlying indebtedness is assumed or taken subject to." (Emphasis added.)

Where the mortgagee is the successful bidder in an action to foreclose a mortgage, the Division deems "the price actually paid or required to be paid" to be the higher of the bid price or the amount of the judgment in foreclosure (see, e.g., Priv Ltr Rul, Commr. of Taxation and Fin. [October 30, 1990] [WL 320172]; Form TP-584). Petitioner claims that the language of the statute provides no authority for the Division's policy. It argues that where the judgment order exceeds the fair market value of the property, consideration should be equal to fair market value. Petitioner notes that its interpretation of "consideration" was recently adopted in the gains tax area³ and urges that the same policy be adopted in the area of real estate transfer tax.

³Laws of 1993 (ch 57, § 60) added the following provision to section 1440 of the gains tax law:

"(d)(i) In the case of a transfer of real property resulting from an action to foreclose a mortgage or lien pursuant to the provisions of the real property actions and proceedings law, where the mortgagee or lienor (or any agent or nominee thereof) is the successful bidder, consideration means the sum of (A) the higher of

Petitioner also contends that its interpretation of section 1401(d) reflects the economic realities of a conveyance pursuant to a foreclosure proceeding. The Division has not put forth a legal argument or statement of policy in support of its position and has not responded to petitioner's legal arguments. Its attorney alleges that petitioner has not established the fair market value of the real property, and, therefore, there are unresolved issues of fact requiring a hearing.

I agree with petitioner that Tax Law § 1401(d) does not provide statutory authority for the Division's policy. To properly understand this conclusion, it is necessary to begin with a rudimentary discussion of foreclosure proceedings.

"Foreclosure is the judicial process of realizing upon the lien of a mortgage. It is an action to collect the mortgage debt out of the land by procuring a sale thereof and the application of the proceeds to the discharge of the debt. In the action, the property is sold under the supervision and control of the court and the proceeds are applied to the satisfaction of the mortgage" (78 NY Jur 2d, Mortgages and Deeds of Trust, § 491).

If, after the sale of the mortgaged property, a portion of the debt remains unsatisfied, the plaintiff in the foreclosure action may apply for a deficiency judgment (RPAPL 1371[1]). If a motion for a deficiency judgment is not made under section 1371 of the Real Property Actions and Proceeding Law, "the proceeds of the sale regardless of amount shall be deemed to be in full satisfaction of the mortgage debt and no right to recover any deficiency in any action or proceeding shall exist" (RPAPL 1371[2].)

Pursuant to Tax Law § 1401(d), consideration includes "the cancellation or discharge of an indebtedness or obligation." Pursuant to RPAPL 1371, failure to apply for a deficiency judgment would result in the cancellation of the full amount of the mortgage debt. In that

(1) the price paid by the mortgagee or lienor (the bid price) or (2) the amount of judgment of foreclosure and sale and (B) the amount of all other liens or encumbrances remaining on the real property or interest therein after the transfer, whether the underlying indebtedness is assumed or taken subject to. Provided, however, where such sum exceeds the fair market value of the real property or interest therein, such consideration shall be equal to the fair market value of the real property or interest therein."

instance, the entire amount of the debt (generally, the amount of the judgment order) would be includable in consideration. On the other hand, if a deficiency judgment was granted, the amount of the consideration would be equal to the difference between the amount of the judgment order and the deficiency judgment, because in that instance there would not be a cancellation of the full amount of the mortgage debt. The only thing of value given for the real property would be the amount actually paid: the bid price plus any other expenses reducing the deficiency. Accordingly, the Division's policy of defining consideration as the higher of the bid price or the judgment order is proper only where the petitioner in the foreclosure action has not received a deficiency judgment.

In this proceeding, whether the mortgage debt of \$15,818,094.19 was cancelled as a result of the foreclosure proceeding is a material issue of fact. Since petitioner has provided no evidence on this issue, a hearing is required to determine whether petitioner is entitled to a partial refund of taxes paid.

E. The petition of NET Realty Holding Trust is denied to the extent indicated in Conclusion of Law "C"; and petitioner's motion for summary determination ordering a partial refund of real estate transfer taxes is denied in accordance with Conclusion of Law "D". A hearing to determine whether petitioner is entitled to a partial refund of tax will be scheduled as soon as practicable, at which time petitioner may present all evidence relevant to this issue.

DATED: Troy, New York
August 4, 1994

/s/ Jean Corigliano
ADMINISTRATIVE LAW JUDGE